REPORT TO ILLINOIS COMMERCE COMMISSION

POST 2006 INITIATIVE

PRESENTED BY DAVID F. VITE
PROCUREMENT WORKING GROUP – CONVENER/REPORTER

OCTOBER 15, 2004

Procurement Consensus Attributes

The Procurement Working Group agrees that any approved procurement process, should include the following attributes:

Feature

1. It should be highly transparent.
2. It should allow for a competitive procurement approach.
3. It should provide for the opportunity for full cost recovery to the utilities if they follow the ICC approved procurement approach.
4. It should result in market-based rates for customers.
5 It should include a mechanism for translating the result of the process into retail rates.
6. It should facilitate and encourage supplier participation of all types in the wholesale market.
7. It should facilitate stable rates and mitigate rate volatility for applicable customers for relevant time periods.
8. It should allow for and accommodate RPS, DSM, low income assistance programs, etc.
9. It should require an initial regulatory review to approve and an ongoing regulatory review to oversee and improve the procurement process.
10. It should be capable of implementation prior to January 1, 2007.
11. It should provide specific guidance on crucial issues such as procurement methodology, rate design and allocation of risks and provide flexibility to respond to market conditions.
12. It should provide an agreed upon procurement methodology, which if followed, minimizes the need for after the fact prudence review.
13. It should for reasonable features or contractual safeguards to manage counterparty credit risk.
14. It should reflect lessons learned from States that have restructured and the current state of competition in the retail and wholesale markets in Illinois.
15. Stakeholders should have the opportunity to review and comment on the procurement process and proposed actions.
16. It should clearly assign accountability and risks.
17. It should provide for prompt regulatory review and approval.
18. The stated public policy goals of insuring resource adequacy should be considered in the procurement process or elsewhere.

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PARTICIPATING COMPANIES

C&N
NERA
Il. DCEO
Reliant Energy
Environment Law & Policy Center
Environment Law & Policy Center
City of Chicago
ICC
IRMA
Blue Stary Energy
Morgan Stanley
Constellation
Cook County State's Attny's office
Constellation New Energy
M. C. Wilhem Associates
Peoples Energy Services
Constellation New Energy
ICC
Mid American
Citadel Group
NERA
Cornerstone Energy Group
Exelon Power Team

PARTICIPATING COMPANIES

Illinois Retail Merchants Association
Mid America
Midwest Gen
Midwest Gen
Midwest Gen
Dynegy
U. S. Energy Savings
Peoples Energy Services
NERA
NERA
Constellation New Energy
Constellation New Energy
ComEd
Constellation New Energy
Ameren
Ameren
ICC
CUB
CUB
Foley
Luedees, Robertson & Kevran
Luedees, Robertson & Kevran
University of Illinois
Synapse Energy Economics
Exelon Power Team
USESC
Exelon-Power Team
Peoples Energy Services
City of Chicago
ComEd
Ameren
Community Energy Cooperative
Ill. Attorney General's Office
Exelon Energy
Constellation New Energy
Peoples Energy Services
ComEd
Ameren
GEV Corporation
ComEd
C&N

PARTICIPATING COMPANIES

Cornerstone Energy Group
Attny for Midwest Gen.
ICC
Dynegy, Inc.
Calpine
Midwest Indep. Power Suppliers
Illinois Power
Northbridge Group for ComEd
ComEd
ICC
The Brattle Group
ICC
Environment & energy Div. Asst. State's Attny's office
Law Office of Michael A. Munson
GEV Corp.
Consultants BAI
Peabody Energy
Exelon Power Team
Edison Mission
Mid American
Exelon Corp.
ICC
Brattle
Blue Star Energy
Blue Star Energy
Peabody Energy
Attny General's Office
Conaco Phillips
Select Energy

Scenarios least reflective of the Procurement Working Group Consensus Attributes

Scenario 4
Affiliate Purchases

This Scenario envisions the LSE contracting with an affiliate to satisfy all of the subject load obligation, including risk management. The affiliate, in turn, may contract with other suppliers to provide resources to meet its contractual obligation through market or other mechanisms.

1. Not Transparent
2. Not competitive
3. Price not tied to market
4. Inconsistent with FERC rules
5. Little or no opportunity for stakeholder review
6. Limits ICC oversight & review
7. May be susceptible to affiliate abuse
8. Limits opportunities for non-affiliate suppliers

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SCENARIO 5
COST INDEX BASED PROCUREMENT REGULATIONS

This scenario envisions a regulatory process setting a price benchmark for commodity costs, or for commodity and risk management costs, based on an index or formula. Under this scenario, the regulated LSE is free to design its own procurement strategy. It is at risk if its costs exceed the cap, but can retain at least a share of the benefits if procurement costs are kept below the regulatory benchmark.

1. Could expose customers to short term volatility
2. Higher administration costs
3. Does not encourage wholesale competition
4. Increase risks to utilities

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SCENARIO 7
RATE FREEZE/TRANSITION PERIOD EXTENSION

This scenario envisions an extension of the Mandatory Transition Period beyond January 2, 2007. Under this scenario, utilities could file revised DST rates and otherwise restructure their rates in accordance with Article XVI, but utility rates would otherwise continue to be subject to the bundled rate "freeze" and the existing rules concerning service obligations and competitive declarations.

1. Inconsistent with FERC
2. May lock in higher rates
3. Continues regulatory uncertainty which will stifle investment in generation
4. May extend affiliated transactions with its lack of transparency.

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SCENARIO 8
TRANSACTION PERIOD EXPIRES; REGULATION CONTINUES UNDER EXISTING POST 2006 LAW

This scenario envisions that the Mandatory Transition Period expires without major legislative change. Under this scenario, the ICC will continue to regulate rates for non-competitive service customers under traditional rate regulation principles and the existing statutes applicable to the post-transition period. Utilities could procure energy through any lawful means, including affiliate purchases, subject to any applicable regulatory limitations or requirements for regulatory approval.

1. Could expose customers to short term volatility
2. Would stymie competition in retail market
3. Not a good proxy for efficient local procurement
4. Does not encourage development of wholesale market
5. Inconsistent with FERC rules.
6. May lock in rates higher than customer might see absent of rate freeze
7. Creates regulatory uncertainty
8. Rates may not reflect market prices
9. Increases risk profile to utilities.

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SCENARIO 10
RE-REGULATION OF ELECTRICITY PRODUCTION

This scenario envisions a fundamental change in legislative direction away from restructuring and reliance on markets, and toward a more regulated cost-of-service model for all aspects of the provision of electric utility service. Under this model, production assets would, to the extent possible, be re-regulated, utilities would again have the obligation to control and/or construct production resources, subject to regulatory approval, with cost recovery through regulated rates. The role of the wholesale market in energy procurement would be consciously reduced as production assets are returned to regulatory control.

1. Involves substantial legislative changes
2. Unclear how utilities could acquire generation portfolio
3. Does not foster a competitive wholesale market
4. May involve affiliate power contracts, which reduces transparency.
5. Shifts all costs of new generation to customer
6. Lengthy regulatory process requiring higher administration costs
7. Fuel prices passed to customers.
8. Discourages efficiency.

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LIST OF SCENARIOS CONSIDERED

Scenario 1. *Wholesale market acquisition through "full requirements" auctions.* This scenario envisions a load serving entity ("LSE") "vertically" dividing the load obligation being auctioned into tranches, each of which has the same load shape as the total load being auctioned. Prospective suppliers, which may include affiliates, offer full requirements products to serve one or more tranches, with the winning suppliers being selected via an auction. This process could be used for total load or for the load of one or more classes.

Scenario 2. *Wholesale market acquisition through "full requirements" RFPs.* This scenario envisions an LSE dividing "vertically" the load obligation to be served into tranches, each of which has the same load shape as the total load, and issuing RFPs to the wholesale market seeking vendors to be responsible for supply for each tranche. Winning suppliers affiliated or otherwise, are selected based on criteria identified in the RFP. As with an auction, the process could be used for total load or for the load of one or more classes.

Scenario 3. *Market-based acquisition by horizontal tranche or wholesale market segment.* This scenario envisions the LSE dividing its load into "horizontal" segments either by product type *(e.g.,* 7x24, 5x16, etc.) or by resource characteristic *(e.g.,* baseload, intermediate, peaking), with regulatory approval of the product type and term, and seeking wholesale suppliers for each segment. Winning suppliers, affiliated or otherwise, may be selected based on segment auctions or based on an RFP process. This approach could be used for total load or for the load of one or more classes.

Scenario 3a. Smart Portfolio Management Features. This scenario envisions a laddered portfolio of contracts – full requirements, commodity, or residual contracts as needed. Can include load following components when and if that is the best choice. Renewable energy efficiency, fuel diversity, technology diversity and mix of contract lengths. Use of spot and short-term markets. Regular monitoring of need and markets with opportunities to revamp portfolio over time.

Scenario 4. *Affiliate purchases (including possible affiliate use of market acquisition).* This scenario envisions the LSE contracting with an affiliate to satisfy all of the subject load obligation, including risk management. The affiliate, in turn, may contract with other suppliers to provide resources to meet its contractual obligation through market or other mechanisms.

Scenario 5. *Cost-index (e.g., MVI) based procurement regulation.* This scenario envisions a regulatory process setting a price benchmark for commodity costs, or for commodity and risk management costs, based on an index or formula. Under this scenario, the regulated LSE is free to design its own procurement strategy. It is at risk if its costs exceed the cap, but can retain at least a share of the benefits if procurement costs are kept below the regulatory benchmark.

Scenario 6. *Acquisition pursuant to an administrative Integrated Resource Planning process.* This scenario envisions a periodic formal administrative process during which regulated LSEs would offer resource plans specifying forecast needs, proposed supply resources, and/or proposed procurement processes, which would be subject to review, modification, and approval by the regulator(s). The scenario envisions that acquisition will be consistent with the approved plan.

LIST OF SCENARIOS CONSIDERED
(Continued)

Scenario7. *Rate freeze* / *transition period extension (continuation of current regulation).* This scenario envisions an extension of the Mandatory Transition Period beyond January 2, 2007. Under this scenario, utilities could file revised DST rates and otherwise restructure their rates in accordance with Article XVI, but utility rates would otherwise continue to be subject to the bundled rate "freeze" and the existing rules concerning service obligations and competitive declarations.

Scenario 8. *Re-regulation of electricity production.* This scenario envisions a fundamental change in legislative direction away from restructuring and reliance on markets, and toward a more regulated cost-of-service model for all aspects of the provision of electric utility service. Under this model, production assets would, to the extent possible, be re-regulated, utilities would again have the obligation to control and/or construct production resources, subject to regulatory approval, with cost recovery through regulated rates. The role of the wholesale market in energy procurement would be consciously reduced as production assets are returned to regulatory control.

Scenario 9. Vertically integrated utility supply. This scenario envisions that retail load not served by Retail Electric Suppliers will continue to be provided by an integrated utility which remains responsible for production, transmission, distribution, and customer functions, as prior to restructuring. Under this scenario, the ICC will continue to regulate rates for non-competitive service customers under traditional rate regulation principles. Utilities would be free to construct, purchase, operate and control resources required to supply this load and to collect the costs thereof pursuant to traditional rate of return and regulation (or statutorily authorized alternative regulation plans).

Scenario 10. Re-regulation of electricity production. This scenario envisions a fundamental change in legislative direction away from restructuring and reliance on markets, and toward a more regulated cost-of-service model for all aspects of the provision of electric utility service. Under this model, production assets would, to the extent possible, be re-regulated, utilities would again have the obligation to control and/or construct production resources, subject to regulatory approval, with cost recovery through regulated rates. The role of the wholesale market in energy procurement would be consciously reduced as production assets are returned to regulatory control.

Scenario 11. Utilities exit the supply role (the"Texas Model"). This scenario envisions that the utility is relieved of all responsibility for commodity supply and risk management and provision of default service, and that the default service obligationlis bid out to other suppliers through a market mechanism. All customers are required to choose a RES as its supplier or be placed on default service. Utility rates, regulated under cost of service principles, are limited to unbundled delivery and other remaining utility functions, and are synchronized between default and RES customers.